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IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

FOURTH APPELLATE DISTRICT

DIVISION THREE

CARROLL MORRIS, Plaintiff and Appellant, v. REDWOOD EMPIRE BANCORP et al., Defendants and Respondents.	G033649 (Super. Ct. No. 02CC18523) O P I N I O N

Appeal from a judgment of the Superior Court of Orange County, James P. Gray and David T. McEachen, Judges. Affirmed in part, reversed in part, and remanded.

Lakeshore Law Center, Jeffrey Wilens; Law Office of Kenneth D. Quat and Kenneth D. Quat for Plaintiff and Appellant.

Bill Lockyer, Attorney General, Tom Greene, Chief Assistant Attorney General, Albert Norman Shelden, Assistant Attorney General, Susan E. Henrichsen, Ronald A. Reiter and Michele R. Van Gelderen, Deputy Attorneys General, as Amicus Curiae on behalf of Plaintiff and Appellant.

Rutan & Tucker, John B. Hurlbut, Jr., Steven J. Goon and Treg A. Julander for Defendants and Respondents.

* Pursuant to California Rules of Court, rules 976(b) and 976.1, this opinion is certified for publication with the exception of parts I, III, and IV of the Discussion.

* * *

Plaintiff Carroll Morris (Morris) appeals from a judgment of dismissal entered after the trial court sustained demurrers to his second amended complaint without leave to amend. The complaint alleged a single cause of action under the unfair competition law (UCL) (Bus. & Prof. Code, § 17200)[1] against defendants Redwood Empire Bancorp (Empire), National Bank of the Redwoods (National), Innovative Merchant Solutions (Innovative), and U.S. Merchant Systems (Merchant Systems), challenging a $150 fee charged by defendants upon termination of a credit card merchant account. In sustaining the demurrers, the trial court ruled the National Bank Act of 1864 (12 U.S.C. § 24 [Bank Act]) and associated regulations preempted Morris's unfair competition action. The court also ruled Morris did not allege facts demonstrating Empire's liability.

Although in the unpublished portion of this opinion we agree federal law does not preempt Morris's claims, we conclude the second amended complaint does not state a cause of action under the UCL. Because the court sustained the demurrers of National, Innovative, and Merchant Systems solely on federal preemption grounds, we reverse the judgment and remand to allow Morris the opportunity to plead facts stating a cause of action under the UCL. Because Morris has failed to allege facts sufficient to state any cause of action against Empire despite repeated attempts to do so, we affirm the trial court's dismissal of that defendant.

ALLEGATIONS AND PROCEDURAL BACKGROUND

Morris is an elderly disabled man subsisting on Social Security benefits. In 2001, he was persuaded to start a "work at home" business involving grocery coupons, and named the business "Coupons-R-Us." To process customers' credit cards, Morris

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[1] "The Legislature has given section 17200 et seq. no official name. Accordingly, we are now using the label 'unfair competition law.'" (*Cel-Tech Communications, Inc. v. Los Angeles Cellular Telephone Co*. (1999) 20 Cal.4th 163, 169, fn. 2 (*Cel-Tech*).)

obtained a "merchant account."[2] Accordingly, he executed a merchant application provided by Innovative, National's registered agent. Morris also executed a merchant agreement with National, again provided by Innovative acting as the bank's agent.

The merchant agreement provided that a "discount rate" would be charged for each credit card transaction and, if Morris did not achieve a certain monthly transaction volume, the bank would assess a minimum $25 processing fee. In addition, National charged Morris a monthly $9.50 "customer service fee." The agreement continued indefinitely until terminated. Either party could terminate the agreement with 30 days notice without cause, or immediately under certain circumstances. Although the bank could terminate the agreement without compensation to Morris, termination by Morris required payment of the minimum processing fee for the following 30-day period and a $150 termination fee. The merchant agreement became effective in April 2001. Morris quickly concluded the coupon business was a "scam," canceled the merchant agreement, and paid the $150 termination fee.

Morris filed the present action, alleging in his original complaint the termination fee constituted an illegal business practice under the UCL. Specifically, he alleged the termination fee was a liquidated damages clause under Civil Code section 1671, subdivision (b), and void because the fee was unreasonable. Morris sought relief for himself, and injunctive relief and restitution as a "private attorney general" on behalf of the general public. Morris named as defendants National and National's parent holding company, Empire.

National and Empire demurred. In response, Morris filed a first amended complaint and attached portions of the merchant agreement, along with another merchant agreement used by National. The first amended complaint reiterated the contention the termination fee was an improper liquidated damages penalty, and also contended the fee

[2] Plaintiff does not allege the defendants had any role in persuading him to start his business, or to obtain a merchant account.

was unconscionable under Civil Code section 1670.5. National and Empire again demurred, arguing (1) the merchant agreement's termination fee provision was not a liquidated damages provision, (2) California courts should not use the UCL to regulate complex matters of economic policy, (3) the UCL claim is preempted by the National Bank Act and associated regulations, and (4) Morris failed to allege liability against Empire. The trial court sustained the demurrers with leave to amend, on preemption and the lack of allegations showing Empire's liability. Shortly thereafter, Morris filed his second amended complaint, to which demurrers were again filed and sustained on identical grounds. This time, however, the trial court did not grant leave to amend.

Shortly before the hearing on the demurrers to the second amended complaint, Morris added by Doe amendment defendants Innovative and Merchant Systems, registered agents of National, alleging they were parties to merchant agreements assessing the $150 termination fee. Innovative demurred to the second amended complaint on the same grounds as National and Empire, and additionally argued it was not liable because it was a disclosed agent of National, and was not alleged to have acted tortiously. The trial court sustained Innovative's demurrers without leave to amend on the same grounds as those of National and Empire. Merchant Systems had not yet filed any response to the second amended complaint. At the court's suggestion, Morris and Merchant Systems entered into a stipulation deeming Merchant Systems to have filed a demurrer on the same grounds as the other defendants. The trial court sustained these demurrers without leave to amend on the same grounds.

STANDARD OF REVIEW

A demurrer tests the legal sufficiency of the complaint. (*Traders Sports, Inc. v. City of San Leandro* (2001) 93 Cal.App.4th 37, 43.) Accordingly, in reviewing whether a trial court erred in sustaining a demurrer, we accept as true all facts properly pleaded along with those that might be implied or inferred from those expressly alleged.

(*Marshall v. Gibson, Dunn & Crutcher* (1995) 37 Cal.App.4th 1397, 1403.) We review the trial court's action de novo and exercise our own independent judgment whether a cause of action has been stated under any legal theory. (*Ibid.*; *Moore v. Regents of University of California* (1990) 51 Cal.3d 120, 125.)

DISCUSSION

I

Federal Banking Laws and Regulations Concerning Noninterest Bank Fees Do Not Preempt the UCL

"Whether federal law preempts state law is fundamentally a question whether Congress has intended such a result. [Citations.] [¶] The 'starting presumption' is that Congress has not so intended. [Citations.] [¶] Preemption of state law by federal law is found in 'three circumstances.' [Citations.] [¶] First, there is so-called 'express preemption': 'Congress can define explicitly the extent to which its enactments pre-empt state law. [Citations.] [¶] Second, there is so-called 'field preemption': '[S]tate law is pre-empted where it regulates conduct in a field that Congress intended the Federal Government to occupy exclusively.' [Citations.] [¶] Third, there is so-called 'conflict preemption': '[S]tate law is pre-empted to the extent that it actually conflicts with federal law.' [Citations] Such conflict must be 'of substance and not merely trivial or insubstantial.' [Citation] It exists when it is 'impossible . . . to comply with both state and federal requirements' [citations] or when state law 'stands as an obstacle to the accomplishment and execution of the full purposes and objectives' underlying federal law. [Citations.] Although 'state law is pre-empted to the extent that it actually conflicts with federal law' [citation], it is preempted only to that extent and no further." (*Peatros v. Bank of America* (2000) 22 Cal.4th 147, 157 (*Peatros*).)

The trial court held the Bank Act and its regulations preempted Morris's UCL claims. The Bank Act was enacted, in part, to place national banks on the same footing as their state chartered competitors, effectively insulating them from

discrimination by state legislatures. (*See Mesquite Nat'l Bank v. First of Omaha Serv. Corp.* (1978) 439 U.S. 299, 314.) The Bank Act confers on national banks the authority "[t]o exercise . . . all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes . . . ." (12 U.S.C. § 24 (Seventh)). The phrase "business of banking" is not limited to the powers enumerated in § 24 (Seventh). (*Bank of America v. City and County of San Francisco* (2002) 309 F.3d 551, 562 (*Bank of America*).) The Office of Comptroller of Currency (OCC) "'may authorize additional activities if encompassed by a reasonable interpretation of § 24 (Seventh).'" (*Ibid*.; *Indep. Ins. Agents of Am., Inc. v. Hawke* (D.C. Cir. 2000) 211 F.3d 638, 640.)

Relevant to our discussion, the OCC has promulgated a regulation authorizing banks to assess noninterest fees (Bank Fee Regulation). (12 C.F.R. § 7.4002.) This regulation provides: "A national bank may charge its customers non-interest charges and fees, including deposit account service charges. [¶] . . . All charges and fees should be arrived at by each bank on a competitive basis and not on the basis of any agreement, arrangement, undertaking, understanding, or discussion with other banks or their officers. [¶] . . . The establishment of non-interest charges and fees, their amounts, and the method of calculating them are business decisions to be made by each bank, in its discretion, according to sound banking judgment and safe and sound banking principles. A national bank establishes non-interest charges and fees in accordance with safe and sound banking principles if the bank employs a decision-making process through which it considers the following factors, among others: [¶] (i) The cost incurred by the bank in providing the service; [¶] (ii) The deterrence of misuse by customers of banking services; [¶] (iii) The enhancement of the competitive position of the bank in accordance

with the bank's business plan and marketing strategy; and [¶] (iv) The maintenance of the safety and soundness of the institution." (12 C.F.R. § 7.4002(a)-(b).)

Neither the National Bank Act nor the Bank Fee Regulation preempts state regulation of national banks. "'Consideration of issues arising under the Supremacy Clause "start[s] with the assumption that the historic police powers of the States [are] not to be superseded by . . . Federal Act unless that [is] the clear and manifest purpose of Congress."'" (*Peatros, supra,* 22 Cal.4th at pp. 158-159.) The historic state police powers extend to banking, including national banking. (*Id.* at p. 159.) Even before passage of the National Bank Act, the regulation of national banking has been subject to dual federal and state control. (*Ibid.*)

In *Perdue v. Crocker National Bank* (1985) 38 Cal.3d 913 (*Perdue*), our high court considered the following question: Does a state law claim that a nonsufficient funds (NSF) bank fee was unconscionable create an "actual conflict" with federal law and "stand as an obstacle to the accomplishment of the full purposes Congress sought to achieve"? (*Id*. at p. 932.) The court answered this question in the negative.

The regulation at issue in *Perdue,* like the Bank Fee Regulation here, provided guidelines for banks to follow in setting noninterest fees. The regulation provided: "(a) All charges to customers should be arrived at by each bank on a competitive basis and not on the basis of any agreement, arrangement, undertaking, understanding or discussion with other banks or their officers. [¶] (b) Establishment of deposit account service charges, and the amounts thereof, is a business decision to be made by each bank according to sound banking judgment and federal standards of safety and soundness . . . ." (12 C.F.R. § 7.8000.)

Rather than finding these provisions preempted an unconscionability claim under state law, *Perdue* recognized these regulations provided a useful gauge in determining the unconscionability of a challenged fee. (*Perdue, supra,* 38 Cal.3d at p. 942, fn. 42.) Because the regulatory purpose was to allow banks to set rates and fees in

accordance with market forces, the court found no conflict with state laws designed to prevent oppression in the marketplace and overreaching by banks. (*Id.* at p. 943.) In other words, the court concluded sound banking principles did not require a bank to include unconscionable provisions in contracts with its customers. (*Id.* at pp. 943-944.)

Defendants attempt to distinguish the Bank Fee Regulation from *Perdue* by noting the present regulation expressly authorizes a bank to set the amounts of noninterest fees "in its discretion." (12 C.F.R. § 7.4002(b)(2).) Citing a statement by the OCC, defendants assert "[i]f state law places limits on an unrestricted grant of authority under federal law, the state law will be preempted." (Preemption Determination (65 Fed. Reg. 15039 (March 20, 2000).) Addition of the phrase "in its discretion" to the Bank Fee Regulation did not, however, create an unrestricted grant of authority. The Bank Fee Regulation retains virtually all of its predecessor's provisions regarding how a bank should exercise discretion in setting fees. Nothing in the Bank Act or the Bank Fee Regulation leads us to conclude Congress intended to allow national banks to charge unconscionable fees or impose penalties in violation of state contract law.

Our determination is not in conflict with the two cases cited by defendants in which the Bank Fee Regulation was held to preempt local ordinances. (See *Bank of America, supra,* 309 F.3d 551; *Wells Fargo Bank of Texas N.A. v. James* (5th Cir. 2003) 321 F.3d 488 (*Wells Fargo*).) In *Bank of America,* two cities passed local ordinances prohibiting banks from charging ATM fees to nondepositors. In *Wells Fargo*, the state passed a law prohibiting banks from charging a fee to nonaccount holders who present checks drawn on accounts held by the bank. In both cases, the courts held the Bank Fee Regulation preempted the provisions at issue, but not because federal law preempted the entire field of bank fee regulation. Rather, the courts found a conflict existed between state and federal law because the state and local ordinances *prohibited* an activity the Bank Fee Regulation authorized. (*See Bank of America, supra,* 309 F.3d at p. 564; *Wells Fargo, supra,* 321 F.3d at p. 493.)

In the present case, there is no state law prohibiting national banks from charging termination fees on merchant accounts. Defendants argue there is no real difference between limiting noninterest bank fees by state law contract principles and eliminating them entirely. We disagree. States retain the ability to impose state contract law not in conflict with federal bank regulations. This principle was recognized by the United States Supreme Court in *Barnett Bank of Marion County N.A. v. Nelson* (1996) 517 U.S. 25, observing: "In defining the pre-emptive scope of statutes and regulations granting a power to national banks, . . . normally Congress would not want States to forbid, or to impair significantly, the exercise of a power that Congress explicitly granted. To say this is not to deprive States of the power to regulate national banks, where . . . doing so does not prevent or significantly interfere with the national bank's exercise of its powers."[3] (*Id.* at p. 33.) A state law prohibiting unconscionable noninterest fees to terminate a merchant account poses no "significant interference" with the powers granted under the Bank Fee Regulation.

Our conclusion the trial court incorrectly determined federal law barred Morris's UCL claim is merely the beginning of our analysis. "A judgment of dismissal entered after the trial court has sustained a demurrer without leave to amend will be affirmed on appeal if any of the grounds stated in the demurrer is well taken." (*E. L. White, Inc. v. City of Huntington Beach* (1978) 21 Cal.3d 497, 504.) "[I]t is the validity of the court's action, and not of the reason for its action, which is reviewable." (*Id.* at p. 505, fn. 2, quoting *Weinstock v. Eissler* (1964) 224 Cal.App.2d 212, 225.) Thus, we consider other grounds upon which to uphold the trial court's action.

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[3] The court in *Barnett Bank* held a federal law expressly allowing national banks to sell insurance preempted a state law prohibiting the activity.

II

A. The Termination Fee Is Not a Liquidated Damage Under Civil Code Section 1671

The UCL defines "unfair competition" to include any "unlawful, unfair or fraudulent business act or practice . . . ." (Bus. & Prof. Code, § 17200.) This language is intended to protect consumers as well as business competitors; its prohibitory reach is not limited to deceptive or fraudulent acts, but extends to any unlawful business conduct. (*Committee on Children's Television, Inc. v. General Foods Corp.* (1983) 35 Cal.3d 197, 209-210.) "By proscribing 'any unlawful' business practice, 'section 17200 "borrows" violations of other laws and treats them as unlawful practices' that the unfair competition law makes independently actionable." (*Cel-Tech, supra,* 20 Cal.4th 163, 180.) In the second amended complaint, Morris alleges the termination fee runs afoul of two statutes. Specifically, he alleges the termination fee is an unreasonable liquidated damages provision in violation of Civil Code section 1671, and unconscionable under Civil Code section 1670.5.

Civil Code section 1671, subdivision (b), provides in relevant part: "[A] provision in a contract liquidating the damages for the breach of the contract is valid unless the party seeking to invalidate the provision establishes that the provision was unreasonable under the circumstances existing at the time the contract was made." Absent a relationship between the liquidated damages and the damages the parties anticipated would result from a breach, a liquidated damages clause will be construed as an unenforceable penalty. (*Ridgley v. Topa Thrift & Loan Assn.* (1998) 17 Cal.4th 970, 977.) The question whether a contractual provision is an unenforceable liquidated damages provision is one for the court. (*Beasley v. Wells Fargo Bank* (1991) 235 Cal.App.3d 1383, 1393 (*Beasley*).) Although on demurrer a reviewing court ordinarily assumes as true the facts alleged in the complaint, a pleader's legal characterization of a contract is not controlling, particularly when the contract is attached to the pleading. (See *Barnett v. Fireman's Fund Ins. Co.* (2001) 90 Cal.App.4th 500, 505.)

The $150 termination fee in the merchant agreement is not expressly denominated a liquidated damages provision. Nonetheless, as Morris correctly points out, to determine the legality of a provision, we examine its true function and operation, not the manner in which it is characterized in the contract. (See *Garrett v. Coast & Southern Fed. Sav. & Loan Assn.* (1973) 9 Cal.3d 731, 737 ["We have consistently ignored form and sought out the substance of arrangements which purport to legitimate penalties and forfeitures"].) The merchant agreement's termination provision reads as follows: "Any party may terminate this Agreement at any time with or without cause by providing written notice to the other parties. However, if Merchant terminates this Agreement, Bank and [Innovative] shall have thirty (30) days from date of receipt of the notice to delete Merchant's account during which time Merchant shall remain liable for all fees and charges, including any monthly minimum processing charge and a termination fee of $150.00."

Where a contract for a specified period of time permits a party to terminate the agreement before its expiration in exchange for a lump-sum monetary payment, the payment is considered merely an alternative to performance, and not a penalty. (See *Blank v. Borden* (1974) 11 Cal.3d 963, 970 (*Blank*).) In *Blank,* the Supreme Court held a contract allowing a real property owner to terminate a listing agreement with a broker before its expiration upon the payment of a specified fee was not a liquidated damages provision because the fee was not triggered by a breach or default under the agreement. The court noted the contract presented the owner with a true option or alternative, as follows: "[I]f, during the term of an exclusive-right-to-sell contract, the owner changes his mind and decides that he does not wish to sell the subject property after all, he retains the power to terminate the agent's otherwise exclusive right through the payment of a sum certain set forth in the contract." (*Id*. at p. 970.)

Morris distinguishes the case on the ground the merchant agreement has no termination date. Because the contract is of indefinite duration, Morris contends the

merchant's cancellation is effectively a "breach" of the agreement. We are not persuaded.

Although a contract's characterization of a particular provision is not controlling, to constitute a liquidated damage clause the conduct triggering the payment must in some manner breach the contract. *Perdue* illustrates this point. There, the plaintiff alleged a bank's NSF fee, charged to the bank's customer whenever the customer wrote a check in an amount exceeding available deposits, was a liquidated damages provision subject to the scrutiny of Civil Code section 1671. In rejecting this contention, the court concluded, "because the depositor has never agreed to refrain from writing NSF checks, the writing of such a check is not a breach of contract." (*Perdue, supra*, 38 Cal.3d at p. 932.)

Similarly, Morris never agreed not to terminate the merchant agreement. Indeed, the merchant agreement *expressly* allowed Morris to terminate his performance at any time. Morris notes the lack of any specified duration in the merchant agreement makes payment of the termination fee inevitable. But this very inevitability takes the provision out of the realm of liquidated damages, which by definition are assessed only upon a breach. A merchant seeking to open an account with National knows at some point he or she must pay the $150 termination fee, and may, if desired, create a reserve against this liability. Thus, the fee is merely a deferred charge attendant to initiating the account.

Morris also argues the termination fee effectively operates as a liquidated damage when the merchant agreement is terminated upon an independent breach by the merchant, such as nonpayment of the minimum monthly service fee. This argument misses the point. It is the merchant's termination of the agreement, by whatever means, that triggers the termination fee. Because the agreement expressly allows the merchant to terminate at any time, imposition of the fee is not dependent upon any breach of contract and is therefore not a liquidated damage.

B. Morris Has Not Alleged Facts Sufficient to Demonstrate Unconscionability Under Civil Code Section 1670.5

As a separate and independent basis for the UCL claim, the complaint alleges the termination fee in the merchant agreement is unconscionable under Civil Code section 1670.5. We conclude Morris's factual allegations fail to state an unconscionability claim.[4]

Civil Code section 1670.5, subdivision (a), provides: "If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result." The issue whether a contract provision is unconscionable is a question of law. (*Flores v. Transamerica HomeFirst, Inc*. (2001) 93 Cal.App.4th 846, 851 (*Flores*).)

Although "unconscionability" is a mouthful to articulate, it is far more difficult to define. The doctrine has been described as "chameleon-like" because of its flexibility and insusceptibility to black-letter definition. (*Steinhardt v. Rudolph* (Fla.Dist.Ct.App. 1982) 422 So.2d 884, 890.) Indeed, Civil Code section 1670.5 does not define unconscionability, and at least one commentator observed that "unconscionability is a concept incapable of exact definition." (Comment, *Commercial Secrecy and the Code — The Doctrine of Unconscionability Vindicated* (1968) 9 Wm. & Mary L.Rev. 1143, 1146.) The doctrine's flexibility, however necessary to its use as a judicial "safety valve" to prevent gross injustice, creates the risk courts may intervene to deprive one

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[4] Morris asserts the issue of whether the termination fee as alleged is unconscionable was not raised before the trial court, and thus should not be considered on appeal. We observe, however, the general rule barring new theories on appeal does not apply to appellate review of a trial court's order sustaining a demurrer. (*Smith v. Commonwealth Land Title Ins. Co.* (1986) 177 Cal.App.3d 625, 629-630.) Accordingly, "[a]n appellate court may . . . consider new theories on appeal from the sustaining of a demurrer to challenge or justify the ruling." (*B & P Development Corp. v. City of Saratoga* (1986) 185 Cal.App.3d 949, 959.)

contracting party of his or her bargain simply because the contractual obligations of the dissatisfied party proved more burdensome than originally anticipated. In an analogous context, our high court has observed: "Courts may not simply impose their own notions of the day as to what is fair or unfair. (*Cel-Tech, supra*, 20 Cal.4th at p. 182.) "An undefined standard of what is 'unfair' fails to give businesses adequate guidelines as to what conduct may be challenged and thus enjoined and may sanction arbitrary or unpredictable decisions about what is fair or unfair." (*Cel-Tech, supra*, 20 Cal.4th at p. 185.) While constructing a precise definition of unconscionability may be difficult, certain identifiable factors, properly applied, narrow the scope of the doctrine.

In California, two separate approaches have developed for determining whether a contract or provision thereof is unconscionable. One, based upon the common law doctrine, was outlined by the California Supreme Court in *Graham v. Scissor-Tail, Inc.* (1981) 28 Cal.3d 807 (*Graham*). Under *Graham*, the court first determines whether an allegedly unconscionable contract is one of adhesion.[5] Upon making this finding, the court then must determine whether (a) the contract term was outside of "the reasonable expectations of the [weaker] part[y]," or (b) was "unduly oppressive or 'unconscionable.'" (*Id.* at p. 820.)

A separate test, based upon cases applying the Uniform Commercial Code unconscionability provision views unconscionability as having "procedural" and "substantive" elements. (*A & M Produce Co. v. FMC Corp.* (1982) 135 Cal.App.3d 473 (*A & M Produce*).) "The procedural element requires oppression or surprise. [Citation.] Oppression occurs where a contract involves lack of negotiation and meaningful choice,

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[5] "'The term [contract of adhesion] signifies a standardized contract, which, imposed and drafted by the party of superior bargaining strength, relegates to the subscribing party only the opportunity to adhere to the contract or reject it.'" (*Armendariz v. Foundation Health Psychare Services, Inc.* (2000) 24 Cal.4th 83, 113 (*Armendariz*).) Adhesion contracts "'are, of course, a familiar part of the modern legal landscape . . . . They are also an inevitable fact of life for all citizens — businessman and consumer alike.'" (*Intershop Communications AG v. Superior Court* (2002) 104 Cal.App.4th 191, 201.)

surprise where the allegedly unconscionable provision is hidden within prolix printed form. [Citation.] The substantive element concerns whether a contractual provision reallocates risks in an objectively unreasonable or unexpected manner." (*Jones v. Wells Fargo Bank* (2003) 112 Cal.App.4th 1527, 1539 (*Jones*).) Under this approach, both the procedural and substantive elements must be met before a contract or term will be deemed unconscionable. Both, however, need not be present to the same degree. A sliding scale is applied so that "the more substantively oppressive the contract term, the less evidence of procedural unconscionability is required to come to the conclusion that the term is unenforceable, and vice versa." (*Armendariz, supra,* 24 Cal.4th at p. 114.)

Our Supreme Court in *Perdue, supra,* 38 Cal.3d 913 performed its unconscionability analysis exclusively under the *Graham* approach, but noted the two analytical approaches are not incompatible, declaring: "Both pathways should lead to the same result." (*Id.* at p. 925, fn. 9.) Many years later in *Armendariz,* the court approved both approaches without expressing a preference for either one. (*Armendariz, supra,* 24 Cal.4th at pp. 113-114.) In the recent case of *Little v. Auto Stiegler, Inc.* (2003) 29 Cal.4th 1064 (*Little*), our high court employed exclusively the procedural/substantive approach derived from *A & M Produce.*

Each of the two approaches has generated some confusion in their application. For example, the *Graham* approach commences with a determination of whether the contract is one of adhesion, thus fostering the impression that a nonadhesion contract may never be unconscionable. In *Harper v. Ultimo* (2003) 113 Cal.App.4th 1403 (*Harper*), however, we expressly recognized that a finding of adhesion was not a prerequisite to an unconscionability determination, and held unenforceable certain exculpatory provisions incorporated into, but not attached to, a nonadhesive contract.

Similarly, under the two-pronged "procedural" and "substantive" test of *A & M Produce*, courts often reflexively conclude the finding of an adhesion contract alone satisfies the procedural prong, and immediately move on to the subject of

substantive unconscionability. (See, e.g., *Flores, supra,* 93 Cal.App.4th at p. 853 ["A finding of a contract of adhesion is essentially a finding of procedural unconscionability"].) Consequently, other procedural issues, including surprise, often are ignored when balancing or weighing procedural and substantive unconscionability. Undue reliance on any one procedural factor to the exclusion of others may produce analytical myopia and obscure the larger unconscionability picture. This problem was recognized in *California Grocers Assn. v. Bank of America* (1994) 22 Cal.App.4th 205 (*California Grocers*), where the court criticized the *A & M Produce* approach, noting: "To speak in terms of 'procedural' unconscionability is to elevate the fact of adhesiveness, which is not per se oppressive, to the same level as 'substantive' unconscionability, thus tending to obscure the real issue." (*California Grocers,* at p. 214.)

Nonetheless, the procedural/substantive approach provides a useful framework when properly employed, and conforms more closely to cases decided under the section 2-302 of the Uniform Commercial Code, upon which California's unconscionability statute is based. (See *Perdue, supra,* 38 Cal.3d at p. 925, fns. 9 & 10.) Accordingly, we begin our analysis by considering the issue of procedural unconscionability with the following caveat in mind: Because procedural unconscionability must be measured in a sliding scale with substantive unconscionability, our task is not only to determine *whether* procedural unconscionability exists, but more importantly, *to what degree* it may exist.

"'Procedural unconscionability' concerns the manner in which the contract was negotiated and the circumstances of the parties at that time. [Citation.] It focuses on factors of oppression and surprise. [Citation.] The oppression component arises from an inequality of bargaining power of the parties to the contract and an absence of real negotiation or a meaningful choice on the part of the weaker party." (*Kinney v. United Healthcare Services, Inc.* (1999) 70 Cal.App.4th 1322, 1329 (*Kinney*).)

In *Armendariz* the high court commenced its procedural unconscionability analysis by first determining whether the contract at issue was one of adhesion. Following *Armendariz,* we too begin our analysis of the merchant agreement by determining whether it is an adhesion contract. *Armendariz* defines an adhesion contract as "'a standardized contract, which, imposed and drafted by the party of superior bargaining strength, relegates to the subscribing party only the opportunity to adhere to the contract or reject it.'" (*Armendariz, supra,* 24 Cal.4th at p. 113.)

In support of its legal conclusion the termination fee is part of an "adhesion contract," the second amended complaint alleges (a) Morris is unsophisticated, (b) the merchant agreement was a "form" contract imposed upon him, and (c) the termination fee provision was not negotiated. These allegations, which we must accept as true, demonstrate the merchant agreement was an adhesion contract as defined in *Armendariz*.

Our recognition of the merchant agreement as an adhesion contract, however, heralds the beginning, not the end, of our inquiry into its enforceability. "'To describe a contract as adhesive in character is not to indicate its legal effect. . . . [A] contract of adhesion is fully enforceable according to its terms [Citations] unless certain other factors are present which, under established legal rules — legislative or judicial — operate to render it otherwise.'" (*Perdue, supra,* 38 Cal.3d at p. 925.)

As noted above, courts sometimes equate "adhesion" with "oppression" in ruling that an adhesion contract is procedurally unconscionable.[6] Although adhesion

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[6] Part of the problem may stem from a previous definitions of adhesion requiring the absence of alternative sources. For example, Justice Tobriner defined a contract of adhesion as one that "must be accepted or rejected by the second party on a 'take it or leave it' basis, without opportunity for bargaining *and under such conditions that the 'adherer' cannot obtain the desired product or service save by acquiescing in the form agreement.* [Fn. omitted.]" (*Steven v. Fidelity & Casualty Co*. (1962) 58 Cal.2d 862, 882, italics added.) Such definitions have led some courts to use the terms "adhesion" and "oppression" interchangeably. (See *Dean Witter Reynolds, Inc. v. Superior Court* (1989) 211 Cal.App.3d 758, 768-771 (*Dean Witter*).) The current definition of adhesion used by our Supreme Court, however, does not include a requirement that there exist alternative sources of supply. (See *Armendariz, supra,* 24 Cal.4th at p. 113.)

contracts often are procedurally oppressive, this is not always the case. (See *California Grocers, supra,* 22 Cal.App.4th at p. 214 [recognizing adhesiveness "is not per se oppressive"].) Oppression refers not only to an absence of power to negotiate the terms of a contract, but also to the absence of reasonable market alternatives. In *Madden v. Kaiser Foundation Hospitals* (1976) 17 Cal.3d 699, our state's highest court recognized the point at which an adhesion contract becomes oppressive: "In many cases of adhesion contracts, the weaker party lacks not only the opportunity to bargain but also *any realistic opportunity to look elsewhere for a more favorable contract*; he must either adhere to the standardized agreement *or forego the needed service*." (*Id.* at p. 711, italics added.) Conversely, "the 'oppression' factor of the procedural element of unconscionability may be defeated, if the complaining party has a meaningful choice of reasonably available alternative sources of supply from which to obtain the desired goods and services free of the terms claimed to be unconscionable." (*Dean Witter, supra, 2*11 Cal.App.3d at p. 772.)

Of course, not every opportunity to seek an alternative source of supply is "realistic." Courts have recognized a variety of situations where adhesion contracts are oppressive, despite the availability of alternatives. For example, a sick patient seeking admittance to a hospital is not expected to shop around to find better terms on the admittance form. (See *Tunkl v. Regents of University of California* (1963) 60 Cal.2d 92.) Similarly, "'few employees are in a position to refuse a job because of an arbitration agreement'" in an employment contract. (See *Little, supra,* 29 Cal.4th at p. 1071.)

In the present case, Morris failed to allege he could not have obtained merchant credit card services from another source on different terms. Moreover, unlike situations where the weaker party is under immediate pressure not to seek out alternative sources, Morris was under no such compulsion in attempting to start his business. In a similar context, the court in *West v. Henderson* (1991) 227 Cal.App.3d 1578 (*West*), rejected an unsophisticated tenant's claim of oppression in entering into a commercial

lease for a sandwich shop: "The only oppression on [tenant] we perceive in the circumstances surrounding the signing of the lease was self-imposed. [Tenant] was not in pursuit of life's necessities; this was a business venture. Knowing her own inexperience, she signed the lease without consulting an attorney . . . ." (*Id.* at p. 1587.) Based on the allegations of Morris's second amended complaint, we are able to discern little oppression in the formation of the merchant agreement.

We next turn to the procedural element of "surprise." As noted above, this element unfortunately has been given short shrift by several courts analyzing unconscionability under the *A & M Produce* framework. Procedural surprise focuses on whether the challenged term is hidden in a prolix printed form or is otherwise beyond the reasonable expectation of the weaker party. (See *Jones, supra,* 112 Cal.App.4th at p. 1539; *Harper, supra,* 113 Cal.App.4th at p. 1406.)

In the present case, the second amended complaint contains no allegations that Morris was unaware of the fee when he executed the merchant agreement, or that its terms were misrepresented to him. In his brief, Morris asserts the termination fee is "buried in dense prose." We disagree. The termination fee provision is easily located in the third sentence under the large type heading "ARTICLE IV — TERMINATION AND EFFECT OF TERMINATION," and subheading "4.01 Term: Termination."[7]

That a clear heading in a contract may refute a claim of surprise was recognized in *Woodside Homes of Cal., Inc. v. Superior Court* (2003) 107 Cal.App.4th 723, which held enforceable an arbitration provision in a home sales contract. Although the provision's type style was "small and [did] not stand out," a large type heading

[7] Morris contends he can show surprise by attaching the full agreement to a future amendment to his second amended complaint, and notes the issue of unconscionability was not raised by way of demurrer in the trial court. Although we agree with Morris that he should be given a further opportunity to cure the defects in his UCL cause of action based upon unconscionability, we express no opinion as to whether attaching the approximately 18 pages of the merchant agreement would be sufficient to show surprise.

requiring the purchasers' initials preceded it. (*Id.* at p. 729.) Based largely on the lack of surprise due to the heading, the court in *Woodside* determined that even if the buyers had been provided no meaningful opportunity to negotiate the terms of the contract with the builder, there existed only a "low level" of procedural unconscionability. (*Id.* at p. 730.)

The present case is distinguishable from provisions found to have surprised the weaker party. For example, in *Perdue, supra,* 38 Cal.3d 913, the Supreme Court considered the effect of a $6 bank charge, or NSF fee, for processing each check drawn on accounts lacking funds sufficient to cover the amount of the check. In concluding the plaintiff presented a triable issue of fact regarding unconscionability, the court considered: (1) The NSF fee provision became effective when the depositor opened a checking account and executed a signature card; (2) the NSF fee was not mentioned anywhere on the signature card itself, but was found in other materials not provided to the depositor; and (3) the signature itself was used in part as a handwriting exemplar, whose contractual character was not readily apparent. (*Id.* at p. 928.) Similarly, in our decision in *Harper, supra,* 113 Cal.App.4th 1403, we found surprise when a contract referenced the Better Business Bureau rules, but did not attach a copy of them. We noted a customer executing the contract would "receive a nasty shock" when he or she discovered the severe limitations on liability contained in these rules. (*Id.* at p. 1406.)

The present situation also is distinguishable from *Perdue* and *Harper* because the plaintiffs in those cases were consumers, not merchants. We recognize the concept of unconscionability applies to businesses as well as consumers. (See, e.g., *Graham, supra*, 28 Cal.3d at pp. 818-819; *A & M Produce, supra*, 135 Cal.App.3d at p. 490.) Nonetheless, the merchant agreement allowed Morris to accept credit card payments from his customers, and it is reasonable to expect even an unsophisticated businessman to carefully read, understand, and consider all the terms of an agreement affecting such a vital aspect of his business.

This point was recognized in *West, supra,* 227 Cal.App.3d 1578, when the court concluded that the length of a contract alone does not establish surprise. The court found the tenant had no excuse for not carefully reading the lease and understanding its terms before execution. The court warned parties to exercise care in conducting commercial transactions: "As this case demonstrates, loose business practices, such as failure to read, investigate, and negotiate a commercial contract, often impose significant and costly consequences. [Tenant] apparently saw no reason to protect her own interests at the outset. We will not do so at this late stage. *Parties to commercial contracts fail to read them at their own peril.*" (*Id.* at p. 1587, italics added.)

In sum, we are able to discern little or no procedural unconscionability from the allegations of the second amended complaint.

We now turn our analysis to substantive unconscionability. A provision is substantively unconscionable if it "involves contract terms that are so one-sided as to 'shock the conscience,' or that impose harsh or oppressive terms." (*24 Hour Fitness, Inc. v. Superior Court* (1998) 66 Cal.App.4th 1199, 1213.) The phrases "harsh," "oppressive," and "shock the conscience" are not synonymous with "unreasonable." Basing an unconscionability determination on the reasonableness of a contract provision would inject an inappropriate level of judicial subjectivity into the analysis. "With a concept as nebulous as 'unconscionability' it is important that courts not be thrust in the paternalistic role of intervening to change contractual terms that the parties have agreed to merely because the court believes the terms are unreasonable. The terms must shock the conscience." (*American Software, Inc. v. Ali* (1996) 46 Cal.App.4th 1386, 1391; accord *Kinney, supra,* 70 Cal.App.4th at p. 1330 ["'Substantive unconscionability' focuses on the terms of the agreement and whether those terms are 'so one-sided as to "shock the conscience."' [Citations.]"].)

"[I]t is clear that the price term, like any other term in a contract may be unconscionable. [Citations.] Allegations that the price exceeds cost or fair value,

standing alone, do not state a cause of action. [Citations.] Instead, plaintiff's case will turn upon further allegations and proof setting forth the circumstances of the transaction. [¶] The courts look to the basis and justification for the price [citation], including 'the price actually being paid by . . . other similarly situated consumers in a similar transaction.' [Citation.] . . . While it is unlikely that a court would find a price set by freely competitive market to be unconscionable [citation], the market price set by an oligopoly [[8]] should not be immune from scrutiny." (*Perdue, supra,* 38 Cal.3d at pp. 926-927.)

Morris argues the second amended complaint has adequately alleged substantive unconscionability by noting the termination fee is equivalent to six months of the minimum processing fee. We disagree. Morris has made no allegation that National's termination fee is grossly out of line with fees charged by other banks. Nor has Morris alleged any facts demonstrating the California banking industry is oligopolistic. Morris's allegation the bank incurred no costs in terminating a merchant account construes the notion of "price/cost" too narrowly. Unlike the NSF fees at issue in *Perdue,* National's assessment of the termination fee is, for Morris, a one-time event. Thus, the fee may be viewed not only as a charge to recompense the bank for its costs incurred in closing the account, but as a deferred fee for all of the services provided by the bank in opening, maintaining, and terminating the account. Morris has not alleged the bank incurred no costs in providing these services.

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[8] "An oligopoly is 'a market structure in which a few sellers dominate the sales of a product and where entry of new sellers is difficult or impossible . . . . [¶] Oligopolistic markets are characterized by high market concentration. Usually the four largest producers of a good account for over half the domestic shipments.'" (*California Grocers, supra,* 22 Cal.App.4th at p. 216, quoting ; Hyman, Economics (2d ed. 1992) p. 356.) We express no opinion whether Morris could plead facts alleging California's banking industry to be oligopolistic, but note in passing that, "Banks in our society are commonly most competitive." (*Copesky v. Superior Court* (1991) 229 Cal.App.3d 678, 691.)

Moreover, looking solely to the costs incurred by the bank is myopic. In determining whether a price term is unconscionable, courts also consider the value being conferred upon the plaintiff. (*Carboni v. Arrospide* (1991) 2 Cal.App.4th 76, 84.) From a value perspective, we are skeptical a one-time fee of $150 in exchange for affording a merchant the ability to accept customers' credit cards is so harsh or oppressive as to "shock the conscience." Although Morris's transaction with National ultimately provided no value to him, unconscionability is determined as of the time the contract was entered into, not in light of subsequent events. (*American Software, Inc. v. Ali, supra,* 46 Cal.App.4th at p. 1391.) As one court noted, "[i]t is not the province of the courts to scrutinize all contracts with a paternalistic attitude and summarily conclude that they are partially or totally unenforceable merely because an aggrieved party believes that the contract has subsequently proved to be unfair or less beneficial than anticipated." (*Geldermann & Co., Inc. v. Lane Processing, Inc.* (8th Cir. 1975) 527 F.2d 571, 576.)

Morris also argues the agreement is substantively unconscionable because it is a one-sided fee imposed only on the merchant, not the bank. This, however, does not involve the "one-sided" reallocation of risks found by courts to "shock the conscience."

An unconscionable reallocation of risks occurs when, for example, a manufacturer disclaims all warranties that the product will perform its intended functions, or precludes a buyer's recovery of consequential damages. (*A&M Produce, supra,* 135 Cal.App.3d at pp. 491-493.) In such situations, the seller shifts the risk connected with matters in its own control to the buyer, in contravention of the basic principle that the "risk of loss is most appropriately borne by the party best able to prevent its occurrence." (*Id.* at p. 491.) Imposition of the termination fee upon the merchant here does not reallocate the risk of the bargain in an inappropriate manner. The termination fee is imposed only when the merchant chooses to terminate the agreement.

Our conclusion the second amended complaint fails to allege the termination fee provision is unconscionable does not, however, end the matter. Because

the unconscionability issue was not the basis for defendants' demurrers, Morris never amended his complaint to address it. Thus, Morris should be allowed the opportunity to plead facts demonstrating unconscionability in accordance with the principles discussed herein.

III

A. The Economic Policy Abstention Doctrine Is Not A Complete Bar to UCL Claims Challenging Unconscionable Bank Fees

Defendants contend the trial court's judgment can be upheld on the grounds of two judicially-created doctrines that we will refer to as the "economic abstention" and "safe harbor" doctrines.

Simply put, the economic abstention doctrine provides courts with discretion to decline intervention in cases involving complex areas of economic regulation. (See e.g., *Desert Healthcare Dist. v. PacifiCare FHP, Inc.* (2001) 94 Cal.App.4th 781, 795 [sustaining demurrer without leave to amend in UCL claim where case "would pull the court deep into the thicket of the health care finance industry, an economic arena that courts are ill-equipped to meddle in"]; *Wolfe v. State Farm Fire & Casualty Ins. Co.* (1996) 46 Cal.App.4th 554, 564-565 (*Wolfe*) [UCL claim based on an insurers' refusal to issue earthquake policies after 1994 Northridge earthquake "'does not permit unwarranted judicial intervention in an area of complex economic policy'"].)

The economic abstention doctrine, however, does not automatically operate as a complete bar to claims under the UCL, even in cases involving areas of complex economic policy or agency regulation. For example, the Supreme Court in *Quelimane Co. v. Stewart Title Guaranty Co.* (1998) 19 Cal.4th 26 (*Quelimane*), considered a UCL cause of action based on an alleged conspiracy between title insurers to deny title insurance to purchasers at tax deed sales. In an apparent reference to this doctrine, the court, citing *Wolfe,* observed: "Whether an insurer should be required to offer a particular class of insurance or insure particular risks are matters of complex economic

policy entrusted to the Legislature." (*Quelimane, supra*, at p. 43.) Nonetheless, the court reversed the trial court's sustaining of a demurrer to this cause of action, holding a UCL claim had been properly pleaded. (*Id.* at p. 48.)

More specifically, the economic policy abstention doctrine has never been employed as an absolute bar to UCL claims challenging noninterest bank fees. Indeed, the courts, including our Supreme Court, have repeatedly applied state law doctrines of unconscionability and unlawful liquidated damages to such fees. (See, e.g., *Perdue, supra,* 38 Cal.3d 913 [plaintiff stated a claim against bank for charging an unconscionable NSF fee]; *Beasley, supra,* 235 Cal.App.3d 1383 [affirming judgment in favor of credit card holders where bank's late fees were illegal liquidated damages]; *Hitz v. First Interstate Bank* (1995) 38 Cal.App.4th 274 [ruling that overlimit and late fees were illegal liquidated damages]; *Hirsch v. Bank of America* (2003) 107 Cal.App.4th 708 [cause of action stated for unjust enrichment based on bank's excessive fees to title companies].)

Although not precluding the application of state contract law doctrines to bank fees, however, the economic abstention doctrine has been employed to limit the remedy provided in such cases. For example, in *Beasley,* the plaintiff challenged a bank's imposition of late and overlimit fees on credit cards issued to its customers, contending such fees were excessive liquidated damages under Civil Code section 1671. Although the trial court allowed the plaintiff to seek monetary relief on behalf of herself and others similarly situated, it denied injunctive relief under the UCL because "'the equities do not favor granting injunctive relief, nor, as a matter of policy, is this Court well suited to regulating retail bank pricing via injunction on an ongoing basis.'" (*Beasley, supra,* 235 Cal.App.3d at p. 1391.)[9]

[9] *Beasley* upheld the verdict awarding plaintiff and class members over $5 million in monetary relief, but did not address the propriety of the trial court's refusal to grant injunctive relief.

In *California Grocers,* the plaintiff filed suit against a bank asserting a $3 fee charged for depositing customers' checks written without sufficient funds (a "deposit item returned" or DIR fee) was unconscionable and violated the covenant of good faith and fair dealing. After a nonjury trial, the court rendered judgment for the plaintiff. Finding the bank's cost of the DIR to be $1.50, and a reasonable profit on the fee would be 15 percent, the trial court issued an injunction against the bank lowering its DIR fee to $1.73 for a period of 10 years, subject to modification for good cause. (*California Grocers, supra,* 22 Cal.App.4th at pp. 211-212.) The court of appeal reversed, holding the DIR fee was not unconscionable, and the covenant of good faith and fair dealing was inapplicable.

As an alternative basis for the ruling, however, *California Grocers* held the trial court had abused its discretion in granting an injunction limiting the amount of fees the bank could charge. Recognizing the case involved "a question of economic policy," the court determined that "[j]udicial review of one service fee charged by one bank is an entirely inappropriate method of overseeing bank service fees." (*California Grocers, supra,* 22 Cal.App.4th at p. 218.) The court reasoned: "'[T]he control of charges, if it be desirable, is better accomplished by statute or by regulation authorized by statute than by *ad hoc* decisions of the courts. Legislative committees and an administrative officer charged with regulating an industry have better sources of gathering information and assessing its value than do courts in isolated cases.'" (*Ibid.*)

Despite its broad wording, *California Grocers* did not hold the economic abstention doctrine would foreclose all UCL claims concerning bank fees.[10] Rather, it recognized injunctive relief setting the amount of fees a bank could charge in the future was a regulatory activity to which the judiciary was ill-suited.

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[10] *California Grocers* cited, without apparent disapproval, the trial court's decision in *Beasley* denying injunctive relief while allowing the plaintiff's claim for recovery of previously paid excess fees to proceed to verdict. (*California Grocers, supra,* 22 Cal.App.4th at p. 218.)

Although we agree with the principles enunciated in *California Grocers,* we cannot say as a matter of law Morris could never allege any set of circumstances entitling him to relief. Because Morris has the right to amend his complaint to state a cause of action for unconscionability under the UCL, it is premature to consider what, if any, remedy might be appropriate should that cause of action ultimately be established.

B. The "Safe Harbor" Principle Does Not Apply

Defendants contend Morris's UCL claim is barred because the conduct complained of, the imposition of the termination fee, is expressly permitted by law. In support, defendants cite *Cel-Tech* for the following proposition: "Specific legislation may limit the judiciary's power to declare conduct unfair. If the Legislature has permitted certain conduct or considered a situation and concluded no action should lie, courts may not override that determination. When specific legislation provides a 'safe harbor,' plaintiffs may not use the general unfair competition law to assault that harbor." (*Cel-Tech, supra,* 20 Cal.4th at p. 182.) Defendants assert the National Bank Act created a "safe harbor" for the imposition of a termination fee when it expressly authorized banks to exercise their discretion in setting fees. (See 12 U.S.C. § 93a; 12 C.F.R. § 7.4002.) We disagree.

The "safe harbor" principle of *Cel-Tech* has never been applied in situations where federal law provides the purported harbor. Applying this principle to federal statutory or regulatory law would supplant well-established decisional law surrounding the United States Constitution's Supremacy Clause and the preemption doctrine. As the California Supreme Court recently noted in a similar context, "repeated emphasis upon an alleged federal 'authorization' presents a myopic and oversimplified analysis. The crucial question is, instead, whether the state [law] would stand as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." (*Bronco Wine Co. v. Jolly* (2004) 33 Cal.4th 943, 992-993.)

Because we have already determined federal law does not preempt the UCL as applied to fees charged by national banks, we need not repeat our analysis under the "safe harbor" principle enunciated in *Cel-Tech.*

C. The Visitorial Powers Statute Does Not Bar Morris's Claims Under The UCL

Defendants contend the visitorial powers statute, section 484(a) of title 12 of the United States Code, provides an alternative basis for upholding the judgment. We disagree.

The visitorial powers statute provides: "(a) No national bank shall be subject to any visitorial powers except as authorized by Federal law, vested in the courts of justice or such as shall be, or have been exercised or directed by Congress or by either House thereof or by any committee of Congress or of either House duly authorized." (12 U.S.C. § 484(a).) Federal law defines "visitorial powers" with respect to national banks to include: "(i) Examination of a bank; (ii) Inspection of a bank's books and records; (iii) Regulation and supervision of activities authorized or permitted pursuant to federal banking law; and (iv) Enforcing compliance with any applicable federal or state laws concerning those activities." (12 C.F.R. § 7.4000(a)(2).) "State officials may not exercise visitorial powers with respect to national banks, such as . . . prosecuting enforcement actions, except in limited circumstances authorized by federal law . . . ." (12 C.F.R. § 7.4000(a)(1).)

Defendants contend pursuing an action under the UCL is prosecuting an enforcement action, and by acting as a private attorney general under the UCL, Morris stands in the shoes of the Attorney General. The issue whether an individual may pursue a UCL action against a bank as a private attorney general appears novel, as neither the parties, nor the Attorney General as amicus, have located a single published case addressing this issue. This issue is intriguing, but its resolution here is unnecessary and must await another day.

A demurrer may not be sustained as to a part of a cause of action, even if portions may be subject to a motion to strike. (*PH II, Inc. v. Superior Court* (1995) 33 Cal.App.4th 1680.) Morris brought his cause of action under the UCL not only as a private attorney general, but also in his personal capacity. The Supreme Court in *Perdue* considered whether a state law claim of unconscionability challenging a bank's assessment of noninterest fees would violate the visitorial powers statute, concluding a "plaintiff can state a cause of action for violation of [California law] without violating section 484 . . . ." (*Perdue, supra,* 38 Cal.3d at p. 934, fn. 21.)[11] Because Morris has alleged personal harm, he has standing to bring the action independent of his status as a private attorney general.

Thus, the visitorial powers statute does not provide an alternative basis for sustaining the demurrers without leave to amend.

IV

A. As a Disclosed Agent, Innovative Is Not Liable Under the Facts Presently Alleged

Defendants argue Innovative is merely a disclosed agent of National and cannot be liable for National Bank's actions. We agree.

Agents of a disclosed principal incur no personal liability for nontortious conduct committed within the scope of their agency. (*Filippo Industries, Inc. v. Sun Ins. Co.* (1999) 74 Cal.App.4th 1429, 1443 ["an agent cannot be held liable for breach of a duty which flows from a contract to which he is not party"].) Morris contends he has properly alleged Innovative's status as a party to the merchant agreement, citing the allegations of the second amended complaint indicating the merchant agreements referred to three parties: the merchant, the bank, and the agent. He also contends the portion of the merchant agreement attached to the complaint demonstrates Innovative was a party to the agreement, citing, for example, the merchant agreement's provisions that "IMS and/or

[11] The court did note, however, the visitorial powers statute might impact the plaintiff's discovery of the bank's records.

its Bank will perform all services in accordance with this Agreement," and that either National Bank or Innovative may terminate the contract or collect the termination fee. These contentions are unavailing.

Facts disclosed by exhibits attached to a complaint take precedence over inconsistent allegations in a pleading. (*Holland v. Morse Diesel Internat. Inc.* (2001) 86 Cal.App.4th 1443, 1447; *Dodd v. Citizens Bank of Costa Mesa* (1990) 222 Cal.App.3d 1624, 1627.) The first page of the merchant agreement identifies Innovative as the agent of National. The statements of Innovative's rights and duties in the merchant agreement cited by Morris are entirely consistent with its status as National Bank's agent.

Morris also asserts he has alleged tortious conduct by Innovative. No citation is made to the second amended complaint, and we find no tort causes of action in it. But because Innovative was only recently added as a party, and Morris has not yet had the opportunity to amend his pleading, we conclude Morris should be given leave to amend his claims against Innovative.

B. Morris Should Not Be Given Leave to Amend as to Empire

In the second amended complaint, Morris included Empire in its designation of the "defendants" allegedly responsible for the acts and omissions described in the pleading, but no allegation is made concerning Empire's role. It is not mentioned in any of the agreements attached to the complaint, and the only hint of its involvement is found in Morris's brief, where Empire is described as the parent of National.

Unlike Innovative, Morris has included Empire as a defendant in each version of his complaint. Empire has demurred on the ground Morris failed to allege any facts showing its involvement in the Morris transactions, and the trial court sustained those demurrers on that ground each time. Morris does not contend the trial court erred,

and Morris's reply brief is also silent on the issue. Accordingly, we uphold the trial court's decision sustaining the demurrers of Empire without leave to amend.

V

DISPOSITION

The judgment in favor of Empire is affirmed. The judgment in favor of the other defendants is reversed and remanded for further proceedings consistent with this opinion. The parties are to bear their own costs on appeal.

ARONSON, J.

WE CONCUR:

SILLS, P. J.

O'LEARY, J.